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In the Supreme Court of the United States

OCTOBER TERM, 1995

BARBARA SMILEY, PETITIONER

v.

CITIBANK (SOUTH DAKOTA), N.A.

ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF CALIFORNIA

**BRIEF FOR THE UNITED STATES AND THE
COMPTROLLER OF THE CURRENCY
AS AMICI CURIAE SUPPORTING RESPONDENT**

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

PAUL BENDER
Deputy Solicitor General

IRVING L. GORNSTEIN
*Assistant to the Solicitor
General*

BARBARA C. BIDDLE

JACOB M. LEWIS
Attorneys

*Department of Justice
Washington, D.C. 20530
(202) 514-2217*

JULIE L. WILLIAMS
Chief Counsel

L. ROBERT GRIFFIN

JOAN M. BERNOTT

HORACE G. SNEED

Attorneys

*Office of the Comptroller
of the Currency*

Washington, D.C. 20219

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QUESTION PRESENTED

Whether credit card late fees are "interest" within the meaning of 12 U.S.C. 85, which permits a national bank to charge "interest" on its loans "at the rate allowed" by the State in which the bank is located.

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ON WRIT OF CERTIORARI
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**BRIEF FOR THE UNITED STATES AND THE
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**INTEREST OF THE UNITED STATES AND THE
COMPTROLLER OF THE CURRENCY**

The Comptroller of the Currency is the primary regulator of national banks chartered under the National Bank Act, 12 U.S.C. 21 *et seq.* See *Nations-Bank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995). The resolution of the question presented in this case will affect that responsibility. The Comptroller has issued a regulation that interprets the term "interest" in 12 U.S.C. 85 to include late fees. 61 Fed. Reg. 4869 (daily ed. Feb. 9, 1996) (to be codified at 12 C.F.R. 7.4001(a)). The Comptroller participated as an amicus curiae

before the California Supreme Court in this case, and before the New Jersey Supreme Court in *Sherman v. Citibank (South Dakota)*, N.A., 668 A.2d 1036 (1995), petition for cert. pending, No. 95-991, which raised the same issue.

STATEMENT

1. Respondent Citibank (South Dakota), N.A. (Citibank) is a national bank located in Sioux Falls, South Dakota. Pet. App. 2. Citibank issues credit cards under the "Visa" and "Mastercard" service marks. *Ibid.* Petitioner Barbara Smiley, who lives in Los Angeles County, California, holds two Citibank credit cards. *Ibid.* The agreements for the use of those cards both provide for finance charges on the unpaid balance and late fees for failure to make the minimum required payment on time.

The agreement for one of petitioner's cards (the Classic Card) provides that, if petitioner does not pay the outstanding balance in full before its due date, Citibank will impose a finance charge of 1.65% on the average daily balance for that monthly billing period. J.A. 51-52. A minimum monthly payment is required for outstanding balances. J.A. 55. For each monthly billing period in which petitioner fails to make her minimum monthly payment within 25 days of its due date, Citibank imposes a late fee of \$15 in addition to the monthly finance charge. J.A. 56. The agreement for petitioner's other card (the Preferred Card) provides that, if petitioner does not pay the outstanding balance in full before its due date, Citibank will impose a monthly finance charge of 1.4% on the average daily balance. J.A. 67-68. If petitioner does not make the minimum monthly payment within 15 days of its due date, Citibank will impose a late fee of

\$6 in addition to the monthly finance charge. J.A. 74. If that minimum payment is not received by the next minimum monthly payment due date, Citibank imposes an additional late fee of \$15 or .65% of the outstanding balance, whichever is greater. *Ibid.* The finance charges and late fees imposed by Citibank are permitted by South Dakota law. S.D. Codified Laws Ann. §§ 54-3-1, 54-3-1.1 (1990 & Supp. 1995).

2. In 1992, petitioner filed a class action complaint against Citibank in California superior court on behalf of herself and other California holders of Citibank credit cards. Pet. App. 2. She alleged that Citibank had violated California consumer protection laws by charging its California credit card customers a late fee of up to \$15. *Ibid.* Citibank moved for judgment on the pleadings, arguing that petitioner's claims are preempted by 12 U.S.C. 85, which permits a national bank to charge "interest at the rate allowed by the laws of the State * * * where the bank is located." Pet. App. 3-4.

The superior court initially denied Citibank's motion. Pet. App. 4. After the California court of appeal issued a writ of mandate directing the superior court to either grant Citibank's motion or show cause why it should not be required to do so, however, the superior court granted Citibank's motion. *Id.* at 5. The court of appeal affirmed. *Ibid.*

3. After granting review, the Supreme Court of California affirmed. Pet. App. 1-72. The court held that "interest" under Section 85 includes "a late payment fee, payable contingently in the event of default after maturity." *Id.* at 19. The court reasoned that, at the time of the enactment of Section 85, the term "interest" included any charge for the use or

detention of money, *id.* at 18, and that definition “easily encompasses late payment fees,” *id.* at 21.

The court also concluded that excluding late fees from the definition of “interest” would undermine Congress’s decision to grant national banks “most favored lender” status in the States in which they are located so as to protect them from unfriendly state legislation. Pet. App. 21-22. For example, “a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks*, but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, *not including national banks*, at a level high enough that *they* could lend at a profit.” *Id.* at 22.

The court further concluded that excluding late fees from Section 85 would adversely affect the national banking system. Subjecting national banks to the varying laws of the States on late fees could “throw into confusion the complex system of modern interstate banking” and “undermine the conditions for uniformity and efficiency that would otherwise obtain.” Pet. App. 29. Precluding a national bank from charging the credit terms allowed by the State in which it is located would also have “a corresponding adverse effect on the national bank’s potential customer, whose freedom to borrow on conditions he deems reasonable would also be restricted.” *Ibid.* (emphasis omitted). The court noted that its interpretation was “in line with interpretations of the Comptroller of the Currency, who ‘is charged with the enforcement of the [federal] banking laws.’” *Id.* at 27 (quoting *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995)).

Judge Arabian and Judge George dissented. Pet. App. 42-62, 63-72. Judge Arabian concluded that, by linking the terms “interest” and “rate,” Section 85 limits “interest” to a sum calculated as a percentage of the loan over time. *Id.* at 45-46. Judge George concluded that fees that depend on the borrower’s own conduct during the term of the loan, such as late payment fees, are not “interest” within the meaning of Section 85. *Id.* at 65-66.

SUMMARY OF ARGUMENT

The question presented in this case is whether credit card late fees are “interest” within the meaning of 12 U.S.C. 85, which permits a national bank to charge interest on its loans at the rate allowed by the State in which the bank is located. The Comptroller of the Currency has reasonably concluded that late fees are interest. The Court should defer to that conclusion.

A. The Comptroller’s view that late fees are interest is consistent with the meaning of that term at the time Congress enacted Section 85 in 1864. At that time, interest was defined broadly as any charge for the use or detention of money. Consistent with that understanding, state courts of that era characterized charges for late payment as interest. That was true regardless of whether the late charges were in the form of flat fees or an increase in the percentage interest rate for the loan.

The use of the term “rate” in Section 85 does not limit the late payment fees covered by that provision to those expressed as a percentage of the outstanding balance. When Congress enacted Section 85, the rate of interest meant the amount of interest, and therefore encompassed flat late fees as well as percentage

charges. Flat fees can also readily be converted to percentage charges to determine whether they exceed any applicable percentage limits. They are no less interest when a State puts no percentage limitation on late fees.

The resolution of the question in this case does not depend on whether Citibank's late fee is viewed as a penalty. When a charge is for the use or detention of money, it is interest, regardless of whether it is also aptly characterized as a penalty. Petitioner's contention based on its characterization of Citibank's late fee as a penalty is a claim that the amount of the fee is excessive when compared to the increased risks and costs associated with late payment. Congress has committed that question to the State in which a national bank is located.

B. The Comptroller's conclusion that late fees are interest is also consistent with the purposes of Section 85. Congress enacted Section 85 in order to give national banks most-favored-lender status so that they could establish a firm footing in potentially hostile States. If late fees were not treated as interest, States could give certain preferred state lenders the exclusive right to charge late fees, depriving national banks of their most-favored-lender status and putting them at a significant competitive disadvantage in the marketing of credit cards. Congress also enacted Section 85 with the goal of establishing a national banking system. If national banks were required to shape their late fee charges to meet the varying and changing requirements in the 50 States, it would introduce additional burdens and unnecessary confusion into the already complex system of modern interstate banking.

C. The Comptroller's interpretation is entitled to deference. Congress has delegated to the Comptroller the authority to enforce the National Bank Act and to issue regulations to carry out that responsibility. This Court has therefore held that the Comptroller is entitled to deference when he interprets the requirements of that Act. Petitioner's contention that deference is not warranted because the Comptroller has interpreted Section 85 inconsistently is incorrect. The prior interpretive letters identified by petitioner do not detract from the significance of the Comptroller's current position.

D. Because late fees are interest within the meaning of Section 85, state laws that purport to preclude a national bank from imposing late fees that are allowed by the State in which the bank is located are preempted. Petitioner's view that such state laws are not preempted because it cannot be proved to a certainty that late fees are interest is incorrect. The question whether Section 85 interest includes late fees is governed by ordinary principles of statutory construction and administrative deference. Those principles lead to the conclusion that late fees are interest.

ARGUMENT

THE COMPTROLLER OF THE CURRENCY HAS REASONABLY CONCLUDED THAT CREDIT CARD LATE FEES ARE INTEREST WITHIN THE MEANING OF 12 U.S.C. 85

Section 85, originally enacted as Section 30 of the National Bank Act, ch. 106, 13 Stat. 108 (1864), provides that national banks may "take, receive, reserve, and charge on any loan or discount made * * * interest at the rate allowed by the laws of the State * * * where the bank is located." 12 U.S.C. 85. In *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 413 (1873), the Court held that Section 85 permits national banks to charge the highest interest rate allowed to lenders in the States in which they are located, even if that rate is not available to state banks. The Court concluded that Congress gave national banks that special protection because there was a very real danger that States would seek to undermine the national banks through "unfriendly legislation." *Ibid.* The Court added that, because national banks were established for the purpose of providing a currency for the whole country and to create a market for the loans of the federal government, Congress had always treated national banks as "National favorites." *Ibid.* The Court has since characterized the protection for national banks recognized in *Tiffany* as "'most favored lender' status." *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314 n.26 (1978).¹

¹ Even absent Section 85, state laws that discriminate against national banks or impose an undue burden on their functions would be preempted. *Anderson Nat'l Bank v.*

In *Marquette*, the Court held that Section 85 permits a national bank to charge its out-of-state customers the rate of interest allowed by the State in which the national bank is located. 439 U.S. at 314-319. The Court therefore concluded that a national bank located in Nebraska could charge its Minnesota customers the annual interest rate on their unpaid credit card balances permitted by Nebraska law, even though Minnesota imposed a lower limit. *Id.* at 302. The Court stated that the Congress that enacted Section 85 "fully recognized the interstate nature of American banking" and intended to facilitate a "national banking system" by permitting national banks to offer the interest rate permitted by the State in which it was located to all of its customers. *Id.* at 314-318. The Court rejected the contention that Congress could not have intended to impair a State's traditional power to enact effective usury laws for the protection of its citizens, reasoning that such impairment "has always been implicit in the structure of the National Bank Act, since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates." *Id.* at 318. Although the ease with which credit cards may be obtained through the mail "accentuated" the impairment of state usury laws, that difference did not call for a different result. *Id.* at 318-319.

The question in this case is whether credit card late fees, like the percentage charges on unpaid outstanding balances at issue in *Marquette*, are "interest" within the meaning of Section 85. If late fees are interest under Section 85, a national bank

Lockett, 321 U.S. 233, 248 (1944); *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 436-437 (1819).

may charge its out-of-state cardholders such fees at the rate permitted by the law of the State in which the bank is located, without regard to any limitations imposed by other States. If late fees are not interest under Section 85, limitations on late fees imposed by the States in which credit card customers reside would not be preempted by Section 85.

Resolution of the question presented in this case should begin with the recognition that the Comptroller of the Currency has concluded that late fees are interest within the meaning of Section 85. The Comptroller reached that conclusion at least as early as 1955. At that time, Pennsylvania law permitted lenders to collect a delinquency charge on an installment loan of 6% of the overdue installment or \$15, whichever was smaller. In response to an inquiry concerning whether national banks located in Pennsylvania could impose delinquency charges on installment loans, the Deputy Comptroller replied that Section 85 gave national banks the right to impose the delinquency charges authorized by Pennsylvania law. Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) (*reprinted at App., infra*, 7a-8a). Since 1955, the Comptroller has issued interpretive letters reaffirming the position that Section 85 permits national banks to charge late fees to the extent that such fees are allowed by the State in which the bank is located. Letter from Julie L. Williams, Chief Counsel, to John L. Douglas, Esq. (Feb. 17, 1995), [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,467, at 86,696-86,697; Letter from William P. Bowden, Jr., Chief Counsel, to Robert G. Ballen, Esq. 6 (Feb. 4, 1992); Letter from Robert B. Serino, Deputy Chief Counsel (Policy) (Aug. 11, 1988), [1988-

1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,066 & n.3 (OCC Interpretive Letter No. 452).

On February 9, 1996, the Comptroller published an interpretive regulation incorporating the view that late fees are interest. That regulation states that the term "interest" under Section 85 "includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended." 61 Fed. Reg. 4869 (daily ed. Feb. 9, 1996) (to be codified at 12 C.F.R. 7.4001(a)). Included in that definition are "numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees." *Ibid.*²

In *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995), the Court held that the Comptroller's interpretations of the National Bank Act are entitled to *Chevron* deference. See *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). Accordingly, when a provision of the National Bank Act "is silent or ambiguous" on an issue, the Court defers to the Comptroller's interpretation, so long as it reflects "a permissible construction." *NationsBank*, 115 S. Ct. at 813 (quoting *Chevron*, 467 U.S. at 843). Stated differently, when

² The regulation also states that interest under Section 85 "does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports." 61 Fed. Reg. 4869 (daily ed. Feb. 9, 1996).

the Comptroller's interpretation of the National Bank Act "fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design," the Court gives the Comptroller's judgment "controlling weight." 115 S. Ct. at 813-814 (quoting *Chevron*, 467 U.S. at 844). For reasons that follow, the Comptroller has reasonably concluded that late fees are interest within the meaning of Section 85. The Court should therefore give the Comptroller's interpretation controlling weight.

A. The Comptroller's Conclusion That Late Fees Are Interest Is Consistent With The Meaning Of Interest At The Time Congress Enacted Section 85

1. At the time Section 85 was enacted in 1864, the term "interest" meant any charge by a lender for the use or detention of money. Thus, in a case decided shortly after the enactment of Section 85, the Court defined interest as "the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873). Subsequent cases adopted a similarly broad definition of interest. See *Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) ("Interest is given on money demands as damages for delay in payment, being just compensation to the plaintiff for a default on the part of his debtor."); *United States v. North Carolina*, 136 U.S. 211, 216 (1890) ("Interest * * * is allowed by the courts as damages for the detention of money * * * or of compensation[] to which the [lender] is entitled."); *Shoemaker v. United States*, 147 U.S. 282, 321 (1893) ("Interest * * * [includes] damages, by reason of the failure of the debtor to pay the principal when due.").

Consistent with that understanding of the meaning of interest, nineteenth century case law characterized charges for late payment as interest. That view prevailed regardless of whether the late fees were in the form of flat fees or an increased percentage rate after default. See, e.g., *Daggett v. Pratt*, 15 Mass. 177 (1818) (notes providing for 3% interest if paid at maturity, "if not, six per cent. interest to be paid"); *Wernwag v. Mothershead*, 3 Blackf. 401, 402 (Ind. 1834) (promissory note providing that, if it was not paid when due, the borrower would pay "five dollars interest per week" until the note was paid off); *Wilkinson v. Daniels*, 1 Greene 179, 188 (Iowa 1848) (note providing for 12% interest if paid at maturity, "and if not paid to the day, fifteen per cent"); *Craig v. Pleiss*, 26 Pa. 271, 273 (1856) (concluding that \$25 flat late fee was a "rate of compensation" within a state usury statute). The Comptroller's conclusion that the term "interest" includes late fees is therefore consistent with the meaning that term had at the time Congress enacted Section 85.

2. Petitioner contends (Br. 11, 15-16) that the coupling of the term "rate" with the term "interest" in Section 85 narrows the late fees covered by that provision to those that are charged as a percentage of the outstanding balance. See 12 U.S.C. 85 (permitting a national bank to collect interest "at the rate" allowed by the State in which it is located). Under that interpretation, Citibank's late charge of .65% of the outstanding balance on its Preferred Card would be interest, J.A. 74, while the flat charge of \$15 on its Classic Card would not be, J.A. 56. At the time of the enactment of Section 85, however, the "rate" of interest meant the amount of interest; it was not limited in meaning to a percentage charge. See 2

Noah Webster, *American Dictionary of the English Language* (1828) (def. 2; "rate" means: "Price or amount stated or fixed on any thing. * * * The rate of interest is prescribed by law."); *Craig*, 26 Pa. at 273 (describing a \$25 flat late fee as a "rate of compensation"); *Wernwag*, 3 Blackf. at 402 (describing a flat late fee of \$5 per week as "interest at the rate specified in the note"). The phrase interest "at the rate allowed" by the State therefore encompasses late fees that are expressed in both flat and percentage terms.

The incorrectness of petitioner's view that a flat late fee is not interest under Section 85 becomes clear when a bank charges a flat fee in a State that places a percentage limit on late fees. For example, suppose a State set a limit on late fees of 10% of the outstanding balance. A national bank that charged a \$15 flat late fee on outstanding balances of \$50 clearly could not defend a suit alleging that it had exceeded the lawful rate of interest permitted by Section 85 by claiming that it was charging something other than interest. In that situation, a court would be required to convert the flat fee to a percentage of each customer's balance in order to determine whether the Bank had charged a permissible rate of interest. The Court would conclude that the \$15 fee could be charged to persons with balances of \$150 or more, but not to persons with balances of less than \$150 (10% of \$150 = \$15). If flat late fees are interest within the meaning of Section 85 when a State sets a percentage limit on such fees, they are equally interest under Section 85 when a State like South Dakota sets no limit (percentage or otherwise) on late fees. See *Daggs v. Phoenix Nat'l Bank*, 177 U.S. 549, 554-555 (1900) (Section 85 adopts state law rate of interest even when the applicable

state law permits the parties to agree by contract to any rate of interest).³

3. Petitioner also contends (Br. 32) that Citibank's late fees are not interest because they are not time-based. In fact, however, Citibank's late fees are time-based. Under Citibank's Classic Card agreement, for example, Citibank charges a \$15 late fee for every month in which the minimum payment is not made on time. J.A. 56. If a cardholder continually fails to make the minimum payment, late fees will accrue at the rate of \$15 per month.

4. Petitioner argues (Br. 35-40) that there is a sharp distinction between interest and a penalty, and that Citibank's flat late fee is a penalty rather than interest. When a charge is made for the use or detention of money, however, it does not lose its character as interest within the meaning of Section 85 simply because the charge may also aptly be characterized as a penalty. Indeed, "[t]he institution of interest originated under Roman law as a penalty due from a debtor who delayed or defaulted in repayment of a loan." See *Library of Congress v. Shaw*, 478 U.S. 310, 315 n.2 (1986).

This Court's decision in *Citizens' Nat'l Bank v. Donnell*, 195 U.S. 369 (1904), illustrates that the description of a lending charge as a "penalty" does not remove it from the category of interest covered by Section 85. In that case, a national bank had assessed

³ If the rate allowed by the State needed to be expressed in percentage terms before a flat late fee would be treated as interest, it would mean that South Dakota would have the power to change the outcome in this case by setting an extremely high percentage limit on late fees, such as 500% of the outstanding balance. The scope of Section 85 does not depend on such meaningless distinctions.

an overdraft charge of 12%, which exceeded the permissible rate of interest in the State in which the bank was located. The bank argued that the overdraft charge did not violate Section 85 because it was a penalty for late payment. *Id.* at 373-374. The Court rejected that argument and held that the overdraft charge violated Section 85. *Ibid.*

Petitioner's characterization of Citibank's late fee as a penalty is also incomplete. The Comptroller has concluded that "[c]redit risks associated with delinquent borrowers are typically higher than for comparable borrowers who have not been delinquent, and a bank's costs for monitoring and collecting an account rise if the account is late." Williams Letter, *supra*, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,467, at 86,696. The Comptroller has further concluded that "[c]redit card late fees are increased charges to borrowers who engage in delinquent payment behavior in order to compensate the bank for these increased lending costs and risks, just as banks customarily charge higher rates in other contexts to borrowers who have had payment problems or otherwise appear to pose higher risks." *Ibid.*; see also *Meilink v. Unemployment Reserves Comm'n*, 314 U.S. 564, 567 (1942) (approving the recovery of interest under the Bankruptcy Act exceeding the normal rate to compensate for increased risk and administrative costs associated with delinquent taxpayers).

Petitioner does not deny that late payers impose such increased risks and costs. Nor does petitioner claim that a bank is precluded from seeking to cover those increased risks and costs by imposing higher interest charges on late payers. Instead, petitioner contends (Br. 33, 39) that Citibank's late fee greatly

exceeds any additional risk or cost to the bank that flows from a cardholder's failure to make the minimum payment on time. But that argument is simply a claim that Citibank's late fees are excessive. Congress has committed the question whether an interest charge is excessive to the State in which the national bank is located. Just as Section 85 permits the State in which a bank is located to decide how much a bank should be permitted to profit from its percentage rate finance charges on unpaid balances, so Section 85 permits the State in which a national bank is located to decide whether and how much the bank should be permitted to profit from its late fee charges.⁴

⁴ Petitioner contends (Br. 30, 33, 35) that several decisions of this Court establish that Section 85 draws a distinction between interest and penalties. The cases on which petitioner relies do not support that conclusion. In *Lloyd v. Scott*, 29 U.S. (4 Pet.) 205, 226 (1830), the Court stated that contingent late fees that exceed the lawful usury limit are not regarded as usurious because the borrower may avoid the charge by paying on time. In *Spain v. Hamilton's Adm'r*, 68 U.S. (1 Wall.) 604, 626 (1864), the Court held that certain contingent charges would not be counted against a usury limit because they were not designed to evade that limit. *Lloyd* and *Spain* therefore addressed whether contingent charges were subject to the state usury laws, not whether those charges were interest. In *Meilink*, 314 U.S. at 570, the Court drew a distinction between interest and penalties for purposes of deciding what charges could be recovered under the Bankruptcy Act. But that is because the text of the Bankruptcy Act drew that distinction. *Id.* at 566. And in *United States v. Texas*, 507 U.S. 529, 536 (1993), the Court noted only that the common law right to prejudgment interest did not include the right to collect penalties. See also *Deputy v. du Pont*, 308 U.S. 488, 498 n.11 (1940) (noting that interest means different things in different contexts); cf. *NationsBank*, 115 S. Ct. at 814 (holding that the

B. The Comptroller's Interpretation Furthers The Purposes of Section 85

1. The Comptroller's view that late fees are interest also advances the purposes of Section 85. As previously discussed, in enacting Section 85, Congress intended to protect national banks against "unfriendly State legislation" by according them most-favored-lender status in the State in which they are located. *Tiffany*, 85 U.S. (18 Wall.) at 412. Congress wanted to ensure that national banks would have a "firm footing" in the States in which they were located so that they could compete effectively with other lenders in the State. *Ibid.* If late fees are not interest, a State could give a preferred category of state lenders the exclusive right to charge late fees, effectively divesting national banks of their most-favored-lender status and putting them at a significant competitive disadvantage. Permitting a State to institute that sort of preference would create the very harms that Congress sought to avoid when it enacted Section 85.

The dangers that Congress anticipated in 1864 have not disappeared. For example, for a time, New Jersey permitted only credit unions to charge credit card late fees, giving credit unions a distinct advantage over national banks in marketing such cards. See N.J. Stat. Ann. § 17:13-104(b) (West Supp. 1995). The Comptroller's interpretation of Section 85 does not countenance such "unfriendly" state legislation.

characterization of annuities in other settings as insurance did not preclude the Comptroller from concluding that annuities are not insurance for the purposes of the National Bank Act).

2. The Comptroller's interpretation also accords with the reality that a bank's periodic finance charge and its late fees are part of a package of lending charges. The periodic percentage rate compensates the bank for the time value of money, and the late fee compensates the bank for the increased risks and costs associated with late payment. The two are functionally interrelated. If state law prevents a national bank from imposing a late fee, or limits the amount of such a fee, the bank might then increase the percentage charge on the overall balance due to compensate for the added costs associated with late payers. Different views may be taken on which is a fairer way for banks to recover the additional costs. But the Comptroller could reasonably decide that a bank's recovery of such costs is interest, regardless of which approach a bank takes. Cf. *NationsBank*, 115 S. Ct. at 814-815, 817 (concluding that the functional similarity between annuities and investments that banks typically sell supported the Comptroller's conclusion that the brokerage of annuities is incidental to the business of banking).

3. The Comptroller's conclusion that late fees are interest is also consistent with the Court's recognition in *Marquette* that the National Bank Act was intended to establish and promote a "national banking system," *Marquette*, 439 U.S. at 315 (emphasis added). As the Court noted in *Marquette*, that purpose is facilitated when national banks can offer the lending charges permitted by the State in which they are located to all of their customers. *Id.* at 314-318. If national banks must shape their late fee charges to meet the varying and changing requirements of the 50 States in which they market their cards, it would introduce additional burdens and

unnecessary confusion into the already "complex system of modern interstate banking." *Id.* at 312.

4. Treating late fees as interest that may be charged at the rate allowed by the State in which the bank is located also has advantages for consumers. In particular, it increases the ability of consumers to choose the credit card with the finance terms that best suits their needs. States may take varying approaches to the kind of charges they will permit lenders within their jurisdiction to impose, and banks may take varying approaches to the kinds of credit arrangements they wish to offer within the limits set by the States in which they are located. Some States may permit high percentage finance charges but no late fees; others may set a low percentage limit on finance charges, but permit late fees; and still others may not set any limits on either the percentage finance charge or late fees. Under the interpretation adopted by the Comptroller, consumers in every State will have the ability to select from among a potentially wide variety of options, rather than being restricted to the combination of charges permitted in the consumer's own State.

C. The Comptroller's Interpretation Is Entitled To Deference

1. Petitioner contends (Br. 27-28) that the Comptroller's interpretation is not entitled to deference because Congress has not delegated authority to the Comptroller to enforce or interpret Section 85. But Congress has given the Comptroller broad power to enforce the requirements of the National Bank Act through administrative proceedings, and that includes the authority to enforce Section 85. 12 U.S.C. 93 (power to impose civil penalties on national banks

for violations of the National Bank Act); 12 U.S.C. 1818(b) (power to issue cease-and-desist orders against national banks to prevent violations of any law, rule, or regulation). Congress has also given the Comptroller authority "to prescribe rules and regulations to carry out the responsibilities of the office." 12 U.S.C. 93a. Petitioner's contention that Congress has not given the Comptroller the authority to enforce or interpret Section 85 is therefore incorrect. See also *NationsBank*, 115 S. Ct. at 813 ("As the administrator charged with supervision of the National Bank Act, the Comptroller bears primary responsibility for surveillance of 'the business of banking'" (citations omitted); *Investment Co. Inst. v. Camp*, 401 U.S. 617, 626-627 (1971) ("The Comptroller of the Currency is charged with the enforcement of the banking laws").

As petitioner notes, 12 U.S.C. 86 authorizes a private right of action to recover penalties for violations of Section 85. *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649-650 (1990), holds that an administrative agency does not ordinarily have the authority to interpret enforcement provisions that are reserved for private parties. But this case involves an interpretation of the meaning of Section 85, which may be enforced administratively as well as judicially. It does not involve the interpretation of the scope of the penalties available under Section 86. Petitioner's reliance on *Adams Fruit* is therefore misplaced.

2. Petitioner also contends (Br. 28-29) that the Comptroller's current interpretation of Section 85 is not entitled to deference because it is inconsistent with previous interpretations offered by the Comptroller. An inconsistency in an agency's position, however, does not eliminate the deference that is

owed to the agency's current position. *NationsBank*, 115 S. Ct. at 817. The ultimate inquiry is whether the agency's current position is reasonable. *Id.* at 813. If it is, any inconsistency with prior positions is beside the point.

The interpretive letters relied on by petitioner as evidence of inconsistency do not detract from the force of the Comptroller's current position. In arguing that the Comptroller has previously stated that late fees are not interest under Section 85, petitioner relies on a brief letter issued by then-Comptroller Saxon in 1964. The portion of the letter relied on by petitioner states that "[c]harges for late payments, credit life insurance, recording fees, [and] documentary stamp[s] are illustrations of charges which are made by some banks which would not properly be characterized as interest." App., *infra*, 9a-10a. That letter, however, does not mention Section 85. And from the context of the letter, it appears that then-Comptroller Saxon was not addressing the meaning of interest under Section 85, but was instead addressing what charges would be counted as interest in determining whether a bank had exceeded a State's periodic percentage limit. See *ibid.* (responding to additional questions concerning the periodic percentage rate of certain States and the formula that is used to convert charges to a rate equivalent).

Petitioner argues further (Br. 28-29) that the rationale for the Comptroller's interpretation has changed over time. As petitioner notes, an interpretive letter issued by then-Deputy Chief Counsel Serino in 1988 suggested that a national bank could collect late fees under Section 85, because the State in which the bank was located had defined interest to

include late fees. Serino Letter, *supra*, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,066 & n.3. The Comptroller has since clarified his view that the meaning of the term "interest" under Section 85 is a question of federal law, and that the way a State defines interest for its own purposes is not controlling. Williams Letter, *supra*, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,467, at 86,693-86,694 & n.3. That approach is also embodied in the Comptroller's current regulation. See 61 Fed. Reg. 4858, 4869 (daily ed. Feb. 9, 1996) (to be codified at 12 C.F.R. 7.4001(a) (promulgating federal definition of interest under Section 85)). Petitioner agrees with the Comptroller's current view that what constitutes interest is a question of federal law. The inconsistency in approach identified by petitioner therefore does not have any bearing on the reasonableness of the Comptroller's current position.⁵

D. State Laws That Purport To Limit The Late Fees That A National Bank Located Elsewhere May Collect Are Preempted

1. A state law is preempted by federal law not only when the state law and the federal law are in "irreconcilable conflict," *Barnett Bank of Marion County, N.A. v. Nelson*, No. 94-1837 (Mar. 26, 1996), slip op. 5 (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)), but also when the state law "stands as an obstacle to the accomplishment and

⁵ Because the Comptroller's conclusion that late fees are interest is based on a federal definition of interest, and the California Supreme Court's decision is premised on that same view, the first two questions raised in the petition are not presented in this case.

execution of the full purposes and objectives of Congress," *Barnett Bank*, slip op. 5 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). In this case, Section 85 authorizes a national bank to charge interest at the rate allowed by the State in which the bank is located. Any state law that attempts to limit the interest that Section 85 authorizes national banks to charge "stands as an obstacle" to the achievement of Congress's purposes and is therefore preempted. The Court reached precisely that conclusion in *Marquette*, when it noted that state efforts to limit the amount of interest that Section 85 authorizes a national bank to charge "must, of course, give way to the federal statute." 439 U.S. at 318 n.31; see also *Barnett Bank*, slip op. 5 (when the National Bank Act authorizes a national bank to engage in a particular activity, a State's prohibition of that activity stands as an obstacle to the accomplishment of Congress's purposes and is therefore preempted).

The preemption question presented in this case is no different from the one presented in *Marquette*. Because late fees fall within the category of interest covered by Section 85, state laws that purport to preclude a national bank from imposing late fees that are authorized by the State in which a national bank is located are preempted.

2. Petitioner nonetheless contends (Br. 18) that state laws governing credit card late fees that purport to apply to national banks located elsewhere are not preempted because it cannot be shown "to a certainty" that credit card late fees constitute "interest" within the meaning of Section 85. The question of preemption, however, "is basically one of congressional intent. Did Congress, in enacting the Federal Statute, intend to exercise its constitution-

ally delegated authority to set aside the laws of a State?" *Barnett Bank*, slip op. 4. It is not governed by the kind of rigid rule proposed by petitioner.

The test for preemption proposed by petitioner is particularly unsuited to the resolution of the question presented in this case. This Court's search for legislative intent has been informed by the well-founded assumption that Congress does not ordinarily seek to broadly displace historic state functions. When that is the consequence of preemption, the Court has sometimes looked for a "clear and manifest purpose" to preempt. *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992); *Rice*, 331 U.S. at 230.

Section 85, however, does not affect a State's general power to regulate commercial lending practices. Instead, it governs only the activities of national banks. A national bank is an "instrumentalit[y] of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." *Marquette*, 439 U.S. at 308. Because of the important public function they perform, Congress has long treated national banks as "National favorites." *Tiffany*, 85 U.S. (18 Wall.) at 413. It would be inconsistent with that tradition to require proof to a certainty that Congress intended to preempt a particular state law insofar as it affected national banks. It is therefore not surprising that this Court has decided preemption questions under the National Bank Act without invoking the interpretive principle relied on by petitioner. See *Barnett Bank*, slip op. 4-11; *Marquette*, 439 U.S. at 313-319. Petitioner's state-protective interpretive rule is especially out of place in interpreting Section 85, since Congress enacted that provision with the specific purpose of protecting

national banks from "unfriendly State legislation." *Tiffany*, 85 U.S. (18 Wall.) at 412.

Petitioner's proposed preemption test suffers from an additional defect. Under *NationsBank*, the Comptroller has authority to decide whether a particular charge is interest when Congress's intent is not clear. 115 S. Ct. at 813. Under petitioner's proposed test, however, that very lack of clarity would automatically mean that the particular charge was not interest. Petitioner's approach therefore would deprive the Comptroller of the authority granted by Congress to fill in the gaps in the National Bank Act through regulation and interpretation, a role that does not disappear simply because the Comptroller's interpretation might have the effect of preempting state law. See *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 170 (1982) (holding that a regulation of the Federal Home Loan Bank Board preempted contrary state law, even though the governing federal statute did not speak directly to the issue resolved by the regulation); see also 12 U.S.C. 43 (requiring the Comptroller to give notice and seek public comment before issuing an opinion letter or interpretive rule that has the effect of preempting state consumer protection law).

The question whether late fees are interest within the meaning of Section 85 is therefore governed by ordinary principles of statutory construction and administrative deference. As we have shown, that conventional approach leads to the conclusion that late fees are interest under Section 85.

CONCLUSION

The judgment of the Supreme Court of California should be affirmed.

Respectfully submitted.

JULIE L. WILLIAMS
Chief Counsel
L. ROBERT GRIFFIN
JOAN M. BERNOTT
HORACE G. SNEED
Attorneys
Office of the Comptroller
of the Currency

DREW S. DAYS, III
Solicitor General
FRANK W. HUNGER
Assistant Attorney General
PAUL BENDER
Deputy Solicitor General
IRVING L. GORNSTEIN
Assistant to the Solicitor
General
BARBARA C. BIDDLE
JACOB M. LEWIS
Attorneys

MARCH 1996

APPENDIX A

12 U.S.C. 85 provides:

§ 85. Rate of interest on loans, discounts and purchases

Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under title 62 of the Revised Statutes. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, prov-

ince, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

APPENDIX B

12 C.F.R. 7.4001 [61 Fed. Reg. 4869 (Feb. 9, 1996)] provides:

§ 7.4001 Charging interest at rates permitted competing institutions; charging interest to corporate borrowers.

(a) *Definition.* The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

(b) *Authority.* A national bank located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a national bank making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a national bank may lawfully charge the highest rate permitted to be

charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of loans made by small loan companies.

(c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a national bank is located but state law permits its most favored lender to charge late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

(d) *Usury.* A national bank located in a state the law of which denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by a corporate borrower.

12 C.F.R. 7.4002 [61 Fed. Reg. 4869-4870 (Feb. 9, 1996)] provides:

§ 7.4002 National bank charges.

(a) *Customer charges and fees.* A national bank may charge its customers non-interest charges and fees, including deposit account service charges. For example, a national bank may impose deposit account service charges that its board of directors determines to be reasonable on dormant accounts. A national bank may also charge a borrower reasonable fees for credit reports or investigations with respect to a borrower's credit. All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.

(b) *Considerations.* The establishment of non-interest charges and fees, and the amounts thereof, is a business decision to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A bank reasonably establishes non-interest charges and fees if the bank considers the following factors, among others:

- (1) The cost incurred by the bank, plus a profit margin, in providing the service;
- (2) The deterrence of misuse by customers of banking services;
- (3) The enhancement of the competitive position of the bank in accordance with the bank's marketing strategy; and

(4) The maintenance of the safety and soundness of the institution.

(c) *Interest.* Charges and fees that are "interest" within the meaning of 12 U.S.C. 85 are governed by § 7.4001 and not by this section.

(d) *State law.* The OCC evaluates on a case-by-case basis whether a national bank may establish non-interest charges or fees pursuant to paragraphs (a) and (b) of this section notwithstanding a contrary state law that purports to limit or prohibit such charges or fees. In issuing an opinion on whether such state laws are preempted, the OCC applies preemption principles derived from the Supremacy Clause of the United States Constitution and applicable judicial precedent.

(e) *National bank as fiduciary.* This section does not apply to charges imposed by a national bank in its capacity as a fiduciary, which are governed by 12 CFR part 9.

APPENDIX C

Feb 24, 1955

Reference is made to the question submitted at the recent examiners' meeting by National Bank Examiner L. Dale Shaffer, relating to charges made by some banks in Pennsylvania when the payments on installment loans are extended.

The Pennsylvania Small Loan Act, known as Act No. 70, as amended, may be found in Purden's Pennsylvania Statutes Annotated, Title 7, section 819-1001, subparagraph A(4). The Act specifies that the permissible charge on an installment loan is a principal amount not exceeding \$3,500, covering a period not exceeding three years, shall be at a rate not exceeding \$6 per \$100 per annum upon the original face amount of the loan for the entire period of the loan, which may be collected in advance. The Act also provides:

" . . . No additional amount shall be charged or contracted for, directly or indirectly, on or in connection with any such installment loan, except the following: (a) Delinquency charges not to exceed five cents for each dollar of each installment more than fifteen days in arrears: Provided, That the total of delinquency charges on any such installment loan shall not exceed fifteen dollars, and only one delinquency charge shall be made on any one installment; . . ."

8a

Under the above quoted exception in the law, state banks in Pennsylvania, and therefore national banks under the authority contained in Section 5197 of the Revised Statutes (12 U.S.C. 85) may make a delinquency charge within the permissible limits when monthly installment loan payments are extended.

Very truly yours,

/s/ L. A. JENNINGS
L.A. Jennings
Deputy Comptroller of
the Currency.

9a

APPENDIX D

Jun 25 1964

Mr. David Swankin
Executive Office of The President
President's Committee on Consumer
Interests
Room 183
Washington, D. C.

Dear Mr. Swankin:

In your letter of May 22, 1964, you made three inquiries.

First, you ask the maximum interest rate that a National Bank may charge in certain specified states. Subject to certain exceptions it may generally be stated that National Banks in California, Illinois, Wisconsin and Kansas may charge interest at a rate up to ten per centum per annum, while in Illinois the normal maximum rate is seven per centum per annum.

Secondly, you inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments, credit life insurance, recording fees, documentary stamp are illustrations of charges which are made by

some banks which would not properly be characterized as interest.

Thirdly, you requested information as to the formula used by bank examiner to convert charges to rate equivalent for purpose of determining whether the charges are at an excessive rate. Because of the inter-relation of state laws with Federal laws there is no set formula. The examiner must look at each questioned transaction with the view of uncovering any unlawful practice on the part of the lending institution. In questionable cases the problem is referred to the Law Department of the Office of the Comptroller of the Currency for review.

If you should desire any additional information this Office would be please to furnish such information upon request.

Sincerely,

/s/ JAMES J. SAXON
James J. Saxon
Comptroller of the
Currency

WOM:dm 5/26/64